

Message Text

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XMB-02 OPIC-03 LAB-04 EPG-02 SIL-01 OMB-01 STR-04
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TO SECSTATE WASHDC PRIORITY 5121
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AMCONSUL EDINBURGH

C O N F I D E N T I A L SECTION 01 OF 02 LONDON 09942

PASS TO TREASURY, FRB AND LABOR

E.O. 11652: GDS
TAGS: PGOV, EFIN, ELAB, UK
SUBJECT: COMMONS COMMITTEE CHALLENGES FINANCE BILL

REF: LONDON 9853

SUMMARY - THE GOVERNMENT SUFFERED A SERIES OF REVERSES
ON ITS FINANCE BILL DURING COMMITTEE STAGES JUNE 14.
THE COMMITTEE -- ON WHICH THE GOVERNMENT NO LONGER HAS
AN OVERALL MAJORITY -- APPROVED FOUR AMENDMENTS RAISING
PERSONAL INCOME TAX EXEMPTIONS FOR LOWER INCOME CATE-
GORIES, INCLUDING THOSE OVER 65. THE TOTAL COST TO THE
TREASURY, IF THE CHANGES ARE ENACTED, WOULD BE 450
MILLION POUNDS. TWO LEFT-WING LABOR MPS JOINED WITH
TORIES AND, ON SOME VOTES, MINOR PARTY MPS TO UPSET THE
GOVERNMENT'S FINANCIAL PLANS. ALTHOUGH THE EXTRA FINAN-
CIAL STIMULUS RESULTING FROM THESE AMENDMENTS IS UN-
LIKELY TO CAUSE HMG TO VIOLATE ITS IMF FINANCIAL TAR-
GETS, ITS FLEXIBILITY IN NEGOTIATING A THIRD ROUND OF
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PAY RESTRAINT WITH THE UNIONS WOULD BE SHARPLY REDUCED.
IT IS NOT YET CLEAR WHETHER THE GOVERNMENT WILL BE ABLE
TO REVERSE THE COMMITTEE ACTIONS WHEN THE BILL REACHES
THE FLOOR OF COMMONS, BUT IN ANY EVENT THESE DEVELOP-
MENTS HAVE BEEN POLITICALLY EMBARRASSING, PARTICULARLY
AS REGARDS THE GOVERNMENT/LIBERAL PACT, AND HIGHLIGHT
CALLAGHAN.S PROBLEMS IN GOVERNING WITHOUT AN OVERALL

MAJORITY. END SUMMARY.

1. THE STANDING COMMITTEE CONSIDERING THE GOVERNMENT'S FINANCE BILL JUNE 14 APPROVED FOUR AMENDMENTS WHICH, IF ENACTED, WOULD PROVIDE 450 MILLION POUNDS IN TAX RELIEF TO ALL INCOME GROUPS, INCLUDING THOSE OVER 65. THE GOVERNMENT OPPOSED THESE AMENDMENTS, CHIEF TREASURY SECRETARY JOEL BARNETT CHARACTERIZING THEM AS "APPALLINGLY IRRESPONSIBLE." SINCE THE GOVERNMENT NO LONGER HAS AN OVERALL MAJORITY IN COMMONS, IT DOES NOT HAVE A MAJORITY ON COMMITTEES. IN THIS CASE, ITS POSITION WAS FURTHER WEAKENED BY THE ABSENCE OF ONE LABOR MP WHO WAS ABROAD ON OFFICIAL BUSINESS. OPPOSITION CONSERVATIVE MPS TOOK THE LEAD IN INITIATING THE AMENDMENTS, BUT TWO LABOR LEFT-WINGERS ALSO TABLED CHANGES AND JOINED WITH MINOR PARTY MPS IN SUPPORTING THE TORIES ON SOME OF THE OTHERS.

2. THE KEY AMENDMENTS WOULD RAISE THE LEVELS OF PERSONAL INCOME TAX EXEMPTIONS WELL BEYOND THOSE PROPOSED BY THE CHANCELLOR IN HIS MARCH 29 BUDGET MESSAGE. THE TORY-PROPOSED CHANGES WOULD INCREASE EXEMPTIONS FOR SINGLE AND MARRIED PERSONS AND CARRY A TOTAL COST OF 425 MILLION POUNDS, WHILE AMENDMENTS SPONSORED BY DISSIDENT LABOR MPS WOULD RAISE SIMILAR EXEMPTIONS FOR PENSIONERS, CARRYING A TOTAL COST OF 24 MILLION POUNDS. ANOTHER TORY-SPONSORED AMENDMENT WAS CARRIED WHICH WOULD INDEX THE LEVEL OF PERSONAL EXEMPTIONS TO THE RATE OF INCREASE OF THE RETAIL PRICE INDEX. UNDER ITS TERMS, THE GOVERN-
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MENT WOULD HAVE TO SEEK A POSITIVE VOTE FROM PARLIAMENT IF IT WANTED TO OVERRIDE THE INDEXATION.

3. THE 449 MILLION POUNDS IN TAX REDUCTIONS SHOULD BE SEEN IN THE LIGHT OF THE NET REDUCTION OF 1.5 BILLION POUNDS ANNOUNCED IN THE CHANCELLOR'S BUDGET MESSAGE. EARLIER, UNDER PRESSURE FROM THE LIBERALS' HMG HAD AGREED TO WITHDRAW THE GASOLINE TAX INCREASE AT A COST OF 150-200 MILLION POUNDS DURING THE CURRENT FISCAL YEAR. AS A RESULT OF YESTERDAY'S VOTE, THE TOTAL NET TAX CUT COULD RISE TO ABOUT 2.1 BILLION POUNDS. THIS FIGURE IS NOT LIKELY TO JEOPARDIZE THE 8.7 BILLION POUND PUBLIC SECTOR BORROWING REQUIREMENT TARGET AGREED WITH THE IMF. HOWEVER, IT APPEARS EFFECTIVELY TO PRECLUDE THE CHANCELLOR FROM ADDING ANY MAJOR FISCAL STIMULUS LATER THIS SUMMER OR EARLY IN THE AUTUMN WITHOUT EXCEEDING THE IMF TARGETS. THE CHANCELLOR HAS REPEATEDLY HINTED THAT SUCH CHANGES ARE UNDER ACTIVE CONSIDERATION BECAUSE OF THE CONTINUING SLACKNESS BOTH IN CONSUMPTION

AND MANUFACTURING INVESTMENT.

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4. MORE NARROWLY, THE AMENDMENTS WILL INCREASE THE PERSONAL EXEMPTION FOR BOTH SINGLE AND MARRIED PEOPLE BY 17 PERCENT COMPARED WITH THE 9.5 AND 12.9 PERCENT RISES ORIGINALLY PROPOSED BY THE CHANCELLOR. THIS IS ABOUT IN LINE WITH THE CURRENT RATE OF INFLATION. PENSIONERS' EXEMPTIONS WILL RISE BY 9.4 AND 13.2 PERCENT. RESPECTIVELY FOR SINGLE AND MARRIED PEOPLE, COMPARED WITH THE GOVERNMENT PROPOSALS OF 6.9 AND 9.0 PERCENT. THE AMENDMENT WHICH INDEXES THE LEVEL OF EXEMPTIONS TO RETAIL PRICES WOULD REDUCE THE REVENUES AVAILABLE TO HMG IN TIMES OF RAPID INFLATION.

5. OPPOSITION AND LABOR MPS JUSTIFIED THEIR ACTION ON THE BASIS THAT PERSONAL TAX EXEMPTIONS HAVE NOT KEPT PACE WITH INFLATION. AS LOWER INCOME GROUPS BEGIN TO PAY THEIR INCOMES TAXES, THE INDEX-LINKED EMPLOYMENT BENEFITS MAKE THE DOLE MORE ATTRACTIVE THAN LOW-WAGE EMPLOYMENT.

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6. COMMENT: WHILE THE GOVERNMENT IS CONCERNED ABOUT THE FINANCIAL IMPLICATIONS OF THESE AMENDMENTS, ITS PRINCIPAL WORRY IS HOW THEY MAY AFFECT CURRENT NEGOTIATIONS WITH THE UNIONS OVER PHASE III OF THE INCOMES POLICY. IF THE AMENDMENTS ARE ALLOWED TO STAND THE CHANCELLOR'S LATITUDE IN NEGOTIATING THE THIRD ROUND WILL BE SHARPLY LIMITED AT A TIME WHEN THE UNIONS ARE SHOWING INCREASING RESTIVENESS AND THE LIKELIHOOD OF AN ENFORCEABLE WAGE RESTRAINT PACKAGE IS DIMINISHING. THE GOVERNMENT'S TASK, ACCORDINGLY, WOULD BE MADE SIGNIFICANTLY MORE DIFFICULT.

7. THESE DEVELOPMENTS ILLUSTRATE CLEARLY THE PROBLEMS OF GOVERNING WITHOUT AN OVERALL MAJORITY IN COMMONS' AND SIMILAR INCIDENTS MUST BE EXPECTED IN THE FUTURE. IT IS NOT YET CLEAR WHETHER THE GOVERNMENT WILL BE ABLE TO OVERTURN THE AMENDMENTS WHEN THE BILL RETURNS TO THE FLOOR OF COMMONS, BUT IT WILL NO DOUBT ATTEMPT TO DO SO. FAILING THAT, THE GOVERNMENT WOULD APPEAR TO HAVE SEVERAL ALTERNATIVES -- REVISION, REDUCTION OR ADJUSTMENT OF THE ONE-BILLION-POUND CONDITIONAL TAX REDUCTION OFFERED IN THE CHANCELLOR'S BUDGET MESSAGE OR THE IMPOSITION OF OFFSETTING INCREASES IN INDIRECT TAXATION AMONG THEM. IT IS STILL TOO EARLY, HOWEVER, TO PREDICT HOW THIS SITUATION WILL PLAY OUT.

8. IN ADDITION TO THE POSSIBLE DAMAGE TO THE GOVERNMENT'S STRATEGY IN NEGOTIATING WITH THE UNIONS, THE COMMITTEE'S REVERSES WERE A SOURCE OF CONSIDERABLE POLITICAL EMBARRASSMENT FOR THE GOVERNMENT, PARTICULARLY AS REGARDS THE RENEWAL OF ITS PACT WITH THE LIBERAL PARTY. FOLLOWING ON THE HEELS OF CALLAGHAN'S EXPEDIENT DECISION TO SUSPEND COLLECTIVE GOVERNMENT RESPONSIBILITY ON THE EC DIRECT ELECTIONS ISSUE (REFTEL) THIS DEVELOPMENT TRIGGERED AN EXPLICIT WARNING FROM LIBERAL LEADER STEEL

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IN A TELEVISED POLITICAL BROADCAST JUNE 15 HE CAUTIONED: "I AM NOT SURE WE SHALL BE ABLE TO SECURE ANOTHER AGREEMENT BECAUSE. ESPECIALLY AFTER YESTERDAY, THE LABOR PARTY IS PROVING A DIFFICULT FRAGILE AND INTERNALLY DIVIDED PARTNER UNLESS THEY PULL THEMSELVES TOGETHER. WE MAY HAVE TO HAVE AN ELECTION IN THE AUTUMN." STEEL'S STATEMENT WAS PROBABLY MOTIVATED BY TACTICAL CONSIDERATIONS AND CONTAINS A CERTAIN AMOUNT OF BRAVADO, BUT IT

CANNOT BE ENTIRELY IGNORED, EVEN THOUGH THE LIBERALS' PERFORMANCE OVER THE PAST SIX MONTHS SUGGESTS THEY WOULD BE FOOLISH, IF NOT SUICIDAL, TO PROVOKE AN ELECTION. NOT SURPRISINGLY, THE TORIES WERE QUICK TO EXPLOIT THE GOVERNMENT'S DISCOMFORT, ASSERTING THAT "A GOVERNMENT THAT CANNOT CONTROL TAXATION DOES NOT DESERVE TO GOVERN." HYPERBOLE ASIDE, THERE CAN BE LITTLE DOUBT THE CONSERVATIVES WERE THE WINNERS ON SEVERAL FRONTS. NOT ONLY DID THEY GAIN PSYCHOLOGICALLY FROM THE GOVERNMENT'S EMBARRASSMENT AND ADD TO LIBERAL CONCERN OVER THE GOVERNMENT'S DURABILITY, BUT THEY CAN ALSO TAKE CREDIT FOR ATTEMPTING TO EASE THE TAX BURDEN FOR LOW INCOME INDIVIDUALS AND FAMILIES.

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